91-834

(1)

No. 91-

Supreme Court, U.S.
FILED
OCT 23 1991
OFFICE OF THE CLERK

In the Supreme Court

OF THE

United States

OCTOBER TERM, 1991

HARRIS CASHMAN,
Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE,
Respondents.

PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE NINTH CIRCUIT

RICHARD H. FOSTER
101 California Street
Suite 4040
San Francisco, CA 94111
Telephone (415) 982-1901
Attorney for Petitioner

BOWNE OF SAN FRANCISCO, INC. • 190 NINTH ST. • S.F., CA 94103 • (415) 864-2300

43

QUESTIONS PRESENTED FOR REVIEW

I

Does the Tax Court have the constitutional or statutory authority to expand Section 183 to disallow loss deductions in cases not involving personal expenditures or hobby losses?

II

Could the Tax Court anticipate for years prior to their enactment the Rules established by Congress to regulate "tax shelters" including Section 465 (At Risk) and Section 469 (Passive Activity)?

III

At least prior to the enactment of Section 622, et. seq., (tax treatment of partnership items), can the Commissioner in an alleged partnership tax shelter impute the intent of the seller/promoter/general partner to the buyer/limited partner/taxpayer, who is liable for the tax?

IV

Should the standards regarding the disallowance of favorable tax treatment on the grounds there is no legitimate business activity be governed by the "sham" requirements of *Frank Lyon?*

V

Should the question of the legitimacy of business activity be reviewed by the Court of Appeals as a question of fact, which requires that the Tax Court be "clearly erroneous" or as a question of law, independently reviewable under *Groetzinger* and *Frank Lyon?*

TABLE OF CONTENTS

TABLE OF AUTHORITIES CITED

Cases

Table of Authorities Cited

Internal Revenue Code Sections

Regulations

Other Authorities Cited

No. 91-

In the Supreme Court

OF THE

United States

TERM, 1991

HARRIS CASHMAN,
Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE,
Respondents.

PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE NINTH CIRCUIT

OPINIONS BELOW

The opinion of the Tax Court is reported at 1989 PH Memo, ¶ 89,533 in Appendix A. Appendix B is the opinion of the Court of Appeals which was certified not for publication.

JURISDICTION

Jurisdiction is envoked under Section 1254 of Title 28 USC. Jurisdiction in the District Court involved a claim for refund of income taxes under Sections 7441 and 7442 of the Internal Revenue Code. The decision was affirmed on April 4, 1991. A timely petition for rehearing was denied on July 25, 1991.

STATUTORY OPINIONS INVOLVED

IRC § 183. ACTIVITIES NOT ENGAGED IN FOR PROFIT.

(a) General Rule.—In the case of an activity engaged in by an individual or an S corporation, if such activity is not engaged in for profit, no deduction attributable to such activity shall be allowed under this chapter except as provided in this section.

(b) Deductions Allowable.—In the case of an activity not engaged in for profit to which subsection (a) applies, there shall be allowed—

(1) the deductions which would be allowable under this chapter for the taxable year without regard to whether or not such activity is engaged in for profit, and

(2) a deduction equal to the amount of the deductions which would be allowable under this chapter for the taxable year only if such activity were engaged in for profit, but only to the extent that the gross income derived from such activity for the taxable year exceeds the deductions allowable by reason of paragraph (1).

(c) Activity Not Engaged in for Profit Defined.—For purposes of this section, the term 'activity not engaged in for profit' means any activity other than one with respect to which deductions are allowable for the taxable year under section 162 or under paragraph (1) or (2) of section 212.

(d) Presumption.—If the gross income derived form an activity for 3 or more of the taxable years in the period of 5 consecutive taxable years which ends with the taxable year exceeds the deductions attributable to such activity (determined without regard to whether or not such activity is engaged in for profit), then, unless the Secretary establishes to the contrary, such activity shall be presumed for purposes of this chapter for such taxable year to be an activity engaged in for profit. In the case of an activity which consists in major part of the breeding, training, showing, or racing of horses, the preceding sentence shall be applied by substituting "2" for "3" and "7" for "5."

(e) Special Rule.—

(1) In general.—A determination as to whether the presumption provided by subsection (d) applies with respect to any activity shall, if the taxpayer so elects, not be made before the fourth taxable year (sixth taxable year, in the case of an activity described in the last sentence of such subsection) following the taxable year in which the taxpayer first engages in the activity. For purposes of the preceding sentence, a taxpayer shall be treated as not having engaged in an activity during any taxable year beginning before January 1, 1970.

(2) Initial period.—If the taxpayer makes an election under paragraph (1), the presumption provided by subsection (d) shall apply to each taxable year in the 5-taxable year (or 7-taxable year) period beginning with the taxable year in which the taxpayer first engages in the activity, if the gross income derived from the activity for 13 (or 2 if applicable) or more of the taxable years in such period exceeds the deductions attributable to the activity (determined without regard to whether or not the activity is engaged in for profit).

(3) Election.—An election under paragraph (1) shall be made at such time and manner, and subject to such terms and conditions, as the Secretary may prescribe.

(4) Time for assessing deficiency attributable to activity.—If a taxpayer makes an election under paragraph (1) with respect to an activity, the statutory period for the assessment of any deficiency attributable to such activity shall not expire before the expiration of 2 years after the date prescribed by law (determined without extensions) for filing the return of tax under chapter 1 for the last taxable year in the period of 5 taxable years (or 7 taxable years) to which the election relates. Such deficiency may be assessed notwithstanding the provisions of any law or rule of law which would otherwise prevent such an assessment.

IRC § 269. ACQUISITIONS MADE TO EVADE OR AVOID INCOME TAX.

(a) In General.—If—

(1) any person or persons acquire, or acquired on or after October 8, 1940, directly or indirectly, control of a corporation, or

(2) any corporation acquires, or acquired on or after October 8, 1940, directly or indirectly, property of another corporation, not controlled, directly or indirectly, immediately before such acquisition, by such acquiring corporation or its stockholders, the basis of which property, in the hands of the acquiring corporation, is determined by reference to the basis in the hands of the transferor corporation,

and the principal purpose for which such acquisition was made is evasion or avoidance of Federal income tax by securing the benefit of a deduction, credit or other allowance which such person or corporation would not otherwise enjoy, then the Secretary may disallow such deduction, credit, or other allowance. For purposes of paragraphs (1) and (2), control means the ownership of stock possessing at least 50 percent of the total combined voting power of all classes of stock entitled to vote or at least 50 percent of the total value of shares of all classes of stock of the corporation.

IRC § 465. DEDUCTIONS LIMITED TO AMOUNT AT RISK.

(a) Limitation to Amount at Risk.—

(1) In general.—In the case of—

(A) an individual, and

(B) a C corporation with respect to which the stock ownership requirement of paragraph (2) of section 542(a) is met,

engaged in an activity to which this section applies, any loss from such activity for the taxable year shall be allowed only to the extent of the aggregate amount with respect to which the taxpayer

is at risk (within the meaning of subsection (b)) for such activity at the close of the taxable year.

IRC § 469. PASSIVE ACTIVITY LOSSES AND CREDITS LIMITED.

(c) Passive Activity Defined.—For purposes of this section—

(1) In general.—The term "passive activity" means any activity—

(A) which involves the conduct of any trade or business, and

(B) in which the taxpayer does not materially participate.

IRC § 6221. TAX TREATMENT DETERMINED AT PARTNERSHIP LEVEL.

Except as otherwise provided in this subchapter, the tax treatment of any partnership item shall be determined at the partnership level.

IRC § 6231. DEFINITIONS AND SPECIAL RULES.

(a) Definitions.—For purposes of this subchapter—

(3) Partnership item.—The term "partnership item" means, with respect to a partnership, any item required to be taken into account for the partnership's taxable year under any provision of subtitle A to the extent regulations prescribed by the Secretary provide that, for purposes of this subtitle, such item is more appropriately determined at the partnership level than at the partner level.

STATEMENT OF THE CASE

This petition is in connection with a decision of the Court of Appeals for the 9th Circuit affirming the Tax Court of the United States. The deficiencies confirmed by the Tax Court involved the disallowance of losses through use of Section 183 of the Internal Revenue Code (Hobby Loss Statute). The Tax Court issued its decision on September 27, 1989. The decision of the case was timely appealed to the Court of Appeals 9th Circuit. The decision

was affirmed on April 4, 1991. It was ordered that the opinion was not for publication. A timely petition for rehearing was denied on July 25, 1991. Since one of the issues was primarily the same, the case was consolidated for briefing purposes and ordered submitted to the same panel of the Court of Appeals with taxpayer's twin brother's case, *Morgan Cashman v. U.S.*, No. 90-15806 in the Court of Appeals. This case will be brought to this Court in the near future. It involves additional issues, including the extent of the additional application of the Statute of Limitations to the government in a refund case.

Section 183 (Hobby Loss Statute) was invoked to disallow business losses.

No credit was given to the taxpayer for his cash investment which amounted to $45,000 in 1978 and $30,000 in 1979. It was never contended by the Commissioner that the expenditures were for a hobby. The tax benefit in 1978, given the deficiency that year of $49,667, is $4,667 over the cash actually contributed. All the facts were stipulated except for the testimony of the taxpayer and his brother and the Internal Revenue Service appraisers.

The first investment involved the purchase of a romance novel entitled *The Year of December*. The investment was structured in a way which allowed individuals without publishing experience to enter the literary marketplace, with the publishing distribution and accounting to be done by an experienced publisher. The government's own experts testified that the publisher was one of the strongest independent publishing houses (TR 93). The book sold 51,759 copies. The net profit received from the copies sold was $58,876. In three (3) different years, the publisher distributed to the taxpayer, after all costs, the following amounts by check:

1982	$1,347.45
1983	46.87
1985	1,606.86

The book went through three (3) printings. Both of the government's so-called expert appraisers liked the book. The publisher evidenced his faith by authorizing two (2) additional printings not required by the contract, and did so at his own expense. The government appraisers were not supplied with any of the docu-

ments and contracts concerning this book. They did not know the printing costs or the number of books printed or sold (TR 87). However, in the speculative and highly volatile literary market, one expert was frank enough to admit that predicting the success of a book is mostly luck. The tax court found the "publishing and distribution of a book was a "bona fide activity." The Court further found that the transaction was "bona fide", that the books were published and distributed, and that the publisher/distributor were recognized as established companies in their trade." (Opinion, p. 15). However, in utilizing Section 183 (Hobby Law Statute) in this non hobby situation, it believed it had the authority, in the interest of regulating what is considered an improper tax shelter, to disallow everything, including the $45,000 cash which was "at risk."

The second investment involved a limited partnership known as Dover. This partnership involved the marketing of a large number of books in diversified fields published by reputable and well known publishers and involving authors who were considered experts in their fields, including such famous or infamous authors such as Arthur Schlesinger and E. Howard Hunt. The subjects varied from history to baseball to food.

The general partner was Bromwell & Company, who was also the broker for the individual book, *The Year of December*. Bromwell was the subject of what the Internal Revenue Service calls a "special project." All taxpayer cases, which involved literary projecting sold by him were assigned to one judge, a special trial judge who decided these cases. *See, Elliott v. Comm.*, 84 TC227; *Ziegler v. Comm.*, TC Memo 1984-620; and *Leger v. Comm.;* TC Memo 1987-146. It is apparent from the reading of the Opinion in this case and the other cases cited above, whose transcripts were stipulated into this trial, that the Tax Court considered him a promoter of what now would be called "abusive tax shelters."

The contract for the Dover collection allowed the promoter-general partner 25% off the top. (TR 166)

In the *Leger* case, the same judge as here castigated Bromwell for its avarice. However, in determining intent with respect to the

objective of making a profit, the Tax Court focused "on the objective of the general partner." The Tax Court held that the issue of whether an activity engaged in for profit is considered at the partnership level. This is prior to the addition of the Code of Section 6231 (a) (3) which allowed the Internal Revenue Service to promulgate a regulation which would allow the attribution of intent at the partnership level, rather than that to the taxpayer who made the investment and who must pay the tax. (Tax Equity and Fiscal-Responsibility Act, PL 248 9-3, 1982).

The Tax Court's attempt to utilize the "hobby loss" regulations is awkward and contrived and really only demonstrates that applying Section 183 to a "passive" investor is not appropriate.

At page 10 and 11 of the Opinion, the Court discusses the "hobby loss" regulations. Factors 1 and 3 cover the time and manner in which the taxpayer carried on the activity. Amateur versus professional in the case of hobby losses are important, however, in the case of a passive investor, they are no more important than the ability to drive would be to an investor in General Motors. The length of time spent in investigation of a proposed investment is a criterion for determining investor expertise, but if Cashman was dumb or incautious and had an objective of making a profit, he would be entitled to his deductions. Factor 2, the expertise of the taxpayer can apply to hobbies, but not to passive investments. Factor 4 discussed on page 11 of the Opinion is confusing and irrelevant. What period of depreciation the taxpayer uses would have next to no influence on profit objective. Factors 5 and 6, showing lack of success and losses, would have to be present in any case where the taxpayer deducted a business loss. Factor 8, in which the Tax Court discussed the taxpayer's other income, goes to prove nothing except the fact that the taxpayer had other income from which to deduct his losses. Obviously, this factor will be present in any case where a tax deduction is questioned.

It is abundantly clear that the Tax Court decided this case solely on the basis that the taxpayer was an amateur and not very industrious. Before the passive loss provisions of Section 469, an investor was not required to be bright and hardworking to deduct his losses.

Other than its analysis of the "hobby loss" regulation, the Tax Court only relies in connection with the book, *The Year of December*, on the fact that there was a nonrecourse note. This represents an anticipation of Section 465 of the Code, the "at-risk" statute, which for the purpose of this case did not come into existence until 1979.[1] The other factor listed in the Opinion was that the price was too high. When there is a loss there is a reason. Section 165 is allowed poor business men as well as good business men.

In his application to the Court of Appeals, the taxpayer raised the following issues:

1. Do the Tax Court findings support a ruling invoking Section 183 (Hobby Loss)?

2. Did the Tax Court improperly absorb Section 263 (Acquisitions to Evade or Avoid Tax) into Section 183 (Hobby Loss)?

3. Did the Tax Court improperly anticipate the At Risk statute, Section 465?

4. Did the Tax Court improperly anticipate the passive Activities rule of Section 469?

5. Is the taxpayer entitled to losses on the basis of Section 183(d)(e)?

6. Did the Tax Court improperly impute the intent of a general partner to the limited partner?

7. Did the Tax Court improperly anticipate Section 6221, the Partnership Entity statute?

8. Was the taxpayer entitled at least to his cash out-of-pocket loss?

---

[1] This statute was not extended to publishing until after December 31st, 1978. See the report by the staff of the Joint Committee on Taxation, 95th Congress, 2nd Section, Section 201.

In its review, however, the Court of Appeals failed to even discuss these issues except as follows:

1. With respect to the contention that the Tax Court's finding that the transaction was *bona fide* was inconsistent with the ultimate finding that the tax payer did not have the actual honest objection of making a profit, the Court of Appeals, without discussing the point, simply stated that the finding of the Tax Court was not clearly erroneous.

2. With respect to the contention that the Tax Court exceeded its authority by anticipating the enactment of Sections 465, 469 and 6221, the Court of Appeals simply refused to consider the legislative history of Section 183, the "hobby loss" statute, or the legislative history of the later enacted statute.

3. With respect to the taxpayer's contention that Section 183(d) was applicable because of the profit made in 1982, 1983 and 1985, the Court inaccurately asserted that the proceeds did not exceed "expenses." The Tax Court claimed only that the taxpayer had not proved he had reported it, a non-sequiter.

4. With respect to the contention that the taxpayer was entitled to at least his cash expenditure which was irrevocably lost, the Court of Appeals upheld the Tax Court's forfeiture, apparently on the basis that Section 183 outdoes the "at-risk" statute Section 465, by allowing a forfeiture. In this connection the Court of Appeals is in direct conflict with the 4th Circuit in *Rice's Toyota World v. Commissioner*, 752 Fed 2d. 89 (1985). 55 AFTER 2d 85-580.

REASONS FOR GRANTING THE WRIT

The deficiency in this case is based upon Section 183 of the Internal Revenue Code. Section 183 replaced former Section 270 in 1969. The predecessor Section had been in place for many years and had been enacted to combat the use of tax-deductible funds originally for hobby farms, particularly horse farms, and later to include all hobbies which were used essentially to convert personal expenditures into tax deductions. See *Dreicer v. Commissioner*, 665 F.2d 1292 (1981) pp. 1297-8.

The Senate Committee Report contains the reasons for the changes from former Section 270. As the Commission stated, there were situations where the rearrangement of income and deductions which could allow a taxpayer to avoid the restrictive effect of the statute. *U.S. Code & Congressional Service*, Tax Reform Act of 1969, p. 2133.

The Conference Committee Report to the 1969 Act stated Section 183's intention as follows:

> "5. Hobby losses (secs. 183 and 270 of the code)
>
> The House bill replaces the present hobby loss provision with a rule which disallows the deduction of losses from an activity carried on by the taxpayer where the activity is not carried on with "a reasonable expectation of profit." An activity would be presumed to have been carried on without this expectation of profit where the losses from the activity were greater than $25,000 in 3 out of 5 years."
>
> The Senate amendment makes a series of modifications in this provision:
>
> . . .
>
> (5) In lieu of the presumption in the House provision to the effect that the activity constitutes a *hobby* where there are losses of $25,000 or more in 3 out of 5 years, the Senate amendment substitutes a presumption that the taxpayer is not engaged in carrying on the activity as a hobby if he has profits in 2 out of 5 years (or in the case of an activity which in major part consists of the breeding, training, showing, or racing of horses if he has profits in 2 out of 7 years).
>
> The conference substitute (sec. 213 of the substitute and sec. 183 of the code) follows the Senate amendment except for the effective date relating to the presumption described in No. 5 above." (emphasis added.)

U.S. Code & Congressional Service,
Tax Reform Act of 1969, p. 2412-2413.

There were various technical amendments over the years, but basically there were no substantive changes to the statute.

Commencing in the 1960's but increasing dramatically in the 70's, a business arose which involved the selling of so-called tax shelter. The basic device was one of providing businesses which had a so-called leveraged tax deduction. That is to say, the investment of a small amount of cash with the remainder financed with non-recourse notes would allow tax deductions greatly in excess of the amount invested. For the most part, this activity was based upon the Court's decision in *Crane v. Commissioner* 331 U.S. 1.

The practice toward the end of the 70's was approaching a national disgrace. The Congress, by a whole series of legislation commencing for the purpose of this case in the year 1979, attempted to eliminate the problem. In particular, they passed Section 465 of the Code which limited deductions to the amount "at-risk". *See Regulation of Tax Shelters*, a law review article by Professor Lewicki in 19 *Pacific Law Journal* 101. The 1976 Tax Reform Act added additional factors. In 1981 Section 465 was applied to the investment tax credit. In 1982 by TEFRA Congress imposed a penalty on promoters of abusive tax shelters, including in some circumstances criminal prosecution. By DEFRA in 1984 further enforcement aids were provided by requiring registration and required lists of customers.

In 1986 the Congress added Section 469 which discriminates against passive investors. It is to be noted that this is approximately 8 years after the activities which gave rise to the present controversy. See Regulations of Tax Shelters 19PLJ 101.

1. The Tax Court Exceeded Its Jurisdiction By Expanding Section 183

In the field of taxation, no court should be free to expand taxation statutes further than Congress intended them to be extended. Taxation, possibly more than any other field of Federal law, is peculiarly a creature of Congressional policy. This rule is even more clearly the case with respect to the Tax Court. The Tax Court is a court of limited jurisdiction. It has no authority to create a common law of taxation or to use equitable doctrines to

expand statutes. Even if expanding the statutes would be a good taxation policy. This truism was clearly upheld by this court in *Commissioner v. Gooch M&E Coe,* 320 U.S. 419, 64 S.Ct. 184.

In interpreting Section 183, the Tax Court, commencing in the early 80's, began to expand the Sections to cover situations other than impermissible personal expenditures. In particular, they began to interpret the Sections to cover so-called tax shelters. This can be easily observed by examining the digests of any of the major tax services, such as Prentice Hall & Commerce Clearing House. Prior to that time, the courts limited Section 183 to hobby losses. *See Dreicer v. Commissioner, supra.*

The legislative history of Section 183 clearly indicates that hobby loss personal expenditures were the evil that Congress was attempting to concent. The Congress, also , as we have indicated above, has created a massive group of statutes to regulate tax shelters, "abusive" or not. Congress clearly thought and stated in its Committee Reports that it was changing current law. particularly pertinent in this case is Section 465, the "at-risk" statute. See the legislative history quoted in *U. S. Code & Congressional Service,* at page 3444 to the Tax Reform Act of 1976, where the Congressional Committee discussed tax shelters and leveraged financing by means of non-recourse notes. In this case, the principal reason for disallowing petitioner's losses was the use of non-recourse financing. If Congress is correct in its statement of then-current law, the Tax Court is wrong in allowing non-recourse financing utilization to disallow petition's investment losses *in toto.*

In utilizing the fact that the taxpayer was a passive, ill-informed, unambitious participant in the venture to justify the imposition of Section 183, the Tax Court once again anticipated Congressional action which was not enacted until 1986. That is to say, Section 469 of the Code. It is crystal clear that Congress thought it was changing the law and it clearly indicates that in its Committee Reports. See the Conference Committee Report to the Tax Reform Act of 1986 where it defines passive activities as "trade or business activities in which the taxpayer (or spouse) does not materially participate (i.e., is not involved on a regular, continuous, and substantial basis). . . . ." See also Professor Le-

wicki's Law Review article, "The Regulation of Tax Shelters," 19 *Pacific Law Journal*, 101, 109.

A reading of the Tax Court opinion where it attempts to force the investment activity here into the Procrustean bed of the "hobby loss" statute regulation, 1.183-2 (b), demonstrates without question that Section 183 was not designed to cover tax shelter situations. The very factors that would indicate that a business is not a hobby and not an amateur activity are completely overlooked or distorted to indicate just exactly the opposite of the regulation's intentment. Congress has come around to the point of view urged by the Service that passive investors should be penalized. However, it is beyond the Tax Court's power to anticipate this rule before Congress enacts it.

The importance of the court reviewing this matter is not limited to the small number of cases that remain which involve tax shelter investments made before expansion of the "at-risk" statute 465 in 1979. If the Tax Court's interpretation is allowed to stand, it will have judicially created a remedial device for disallowing losses if they are in any part tax-motivated. Basically, it will have created a new Section 269 or a new fraud statute.

In this case, the Tax Court found that the investment was "*bona fide.*" If on the basis of Section 183 this investment can be disallowed and the taxpayer's cash investment forfeited, the burden of proof can be placed on the taxpayer to prove that taxes have no part in his consideration of the investment or lose his loss deductions under Section 165. In the case of speculative ventures possibly beneficial to the economy in a recession atmosphere, this would have a deadening effect. But for the purpose of this petition, more significantly it will be a rule which the Tax Court rather than the Congress created.

In *Dobson v. Commissioner*, 320 U.S. 489, 64 C. Ct. 239, this Court of Appeals "admonished courts not to apply to the Tax Court rules of taxation not based upon the statute but upon their ideas of right accounting or tax practice," at 497. The present court should admonish the Tax Court not to create new rules unauthorized or unintended by Congress.

A word should be said with respect to the Appellate review in this matter. The Court of Appeals refused to consider the legislative history at all of either Section 183 or the multitude of tax shelter correctives. In *Train v. Colo. Public Interest Research Group,* the court reversed the Court of Appeals for refusing to consider the legislative history even when the statute appears to be plain or unambiguous. 96 S.Ct. 1938 (1976). As the Court observed:

> "When aid to construction of the meaning of words, as used in the statute, is available, there certainly can be no 'rule of law' which forbids its use, however clear the words may appear on 'superficial examination.' *United States v. American Trucking Assns.,* 310 U.S. 53 543-544, 60 S.Ct. 1059, 1064, 84 L.Ed. 134 1351 (1940) (footnotes omitted). See *Cass v. United States,* 417 U.S. 72, 77-79, 94 S.Ct. 2167, 2170-2071, 10 L.Ed. 2d 668, 673-67 (1974). See generally Murphy, Old Maxims Never Die: The "Plain-Meaning Rule" and Statutory Interpreatation in the "Modern" Federal Court, 75 Col.L.Rev. 1299 (1975). In this case, as we shall see, the legislative history sheds ccnsiderable light on the question before the Court." At p. 1942.

See also *Commissioner v. Bilder,* 82 S.Ct. 881 (1962), where in a tax case, this court reversed for failure to consider applicable legislative history.

The Court presently has before it the case of *Doherty v. IRS,* 908 F.2d 1108, 2d Cir. (1990). *Doherty* involved the reversal of an Immigration tribunal for disregarding the legislative history of an immigration statute. Apparently it is the Government's position that longstanding immigration service practice and interpretation of the law should prevail. However this case does not involve conflicting and isolated comments by legislators. We cannot believe that the Justice or the Court would allow the IRS practice to override legislative history as expressed in Committee Reports and a whole series of special legislation regulating tax shelters. We only mention the *Doherty* case in the event that the Court's decisions and analysis of the problem of legislative history be pertinent to this case.

The Tax Court and the Commissioner's utilization of Section 183 to anticipate the special regulation of tax shelters of Section 465, the "at-risk" statute, and Section 469, the passive investment statute, and the rest, might be good tax policy. Certainly it would provide more equality of treatment between investors who invested before the effective date of the statutes, in contrast to the investors who invested after the effective date of the statutes. This might be desirable but it is beyond the statutory and constitutional power of the Tax Court to do so.

Allowing this overreaching will legitimize a practice where without legitimate authority the Internal Revenue Service has inhibited certain industries by a policy of disallowing deductions for business losses. An examination of the Tax Court cases under Section 183 will reveal a surprising focusing of loss disallowance in the entertainment and literary fields. There are those that believe that censorship by the IRS is more to be feared than by withholding of grants on certain kinds of artistic creations. In the companion case to this one involving the same or similar literary properties, the District Judge accepted the evaluations of an expert whose expertise was in the production of Sunday School tracts and video tapes of a denominational religious character.

2. The Disallowance Of Loss Deductions In The Absence Of Specific Legislation Should Conform To The Rule Of Frank Lyon Co. v. U.S.

We are not suggesting that losses cannot be disallowed unless specific tax shelter statutes enacted by Congress disallow them. In *Frank Lyon Co. v. U.S.* 98 S.Ct. 1291 (1978) the Supreme Court confirmed the rule that sham transactions can be disregarded and deductions for such activities denied. The *Frank Lyon Co.* rule has been interpreted by two Court of Appeals decisions as countenancing "a two-party test." "That is, a transaction is a sham if (1) it is not motivated by any economic purpose outside of tax considerations, and (2) is without economic substance because no real potential for profit exists." At. 725-726. See also *Rice's Toyota World, supra,* at 91-92. *Shriver v. Commissioner,* 899 F.2d. 724, 8th Cir. (1990), at 725. The standards required by the Tax Court to apply Section 183 to non-hobby situations are certainly not very clear. This case is possibly an extreme example

where the Tax Court and Commissioner were allowed to utilize the section where the transaction was "bona fide." It also was allowed to find "tax motivation" where the investment produced slightly over $4,000.00 of tax benefits over the cash investment of $45,000.00. The Tax Court here disregarding its attempt to force the square peg of the passive investor's investment through the round hole of hobby loss regulations was based only on the high price of the books and the use of non-recourse financing. Certainly not the kind of evidence which would justify a finding under *Frank Lyon Co.*

This Court should in the absence of specific congressional enactment, deny the Commissioner the opportunity to disallow losses under Section 183 or any other general statute unless it confirms to the rules of *Frank Lyon Co.* and is a "genuine sham."

A further reason exists for reviewing this matter as is well expressed in the *Shriver* case at p. 797. The courts are not in agreement as to whether both parts of the test are required or only one. See *Freidman v. Commissioner* 86, F. 2d 785, at 792, 4th Cir. (1989), *Kirshman v. Commissioner* 862 F.2d 851, 6th Cir. (1989).

Furthermore, the Court should bring into conformation with *Frank Lyon Co.* the allowance of a taxpayer's cash or cash equivalent investment in situations where elements of personal pleasure and personal expenditures are not involved. That is to say, non-hobby cases.

3. The Court Should Not Allow The Imputation Of A Tax Shelter Promoter's Intent To The Taxpayer

In view of the close to extortional provisions allowed the General Partner under the Limited Partnership Agreement, we raised in the Tax Court the question of whether the taxpayer was entitled to a theft loss under *Nichols v. Commissioner*, 43 T.C. 842. There in an admittedly tax-motivated tax shelter situation, the Tax Court allowed a theft deduction for the sham investment to the extent of the cash contributed. Whether that defense was viable or not does not change the fact that in promoting tax shelter investments the motivation of the promoter is primarily for his own profit rather than that of the investor. Imputing his intent

to the taxpayer defies common sense. In this case, the Tax Court did not even bother to define what his intent was except to cite prior cases where the promoter was castigated.

The phrase "profit motivation" determined at a Partnership level slides trippingly over the page as if it was the expression of some great and profound truth. In the context of the economic reality of tax shelters, however, it not only does not make sense but could lead to ridiculous results. In this case, it could lead to sustaining the petitioner's individual book property investment on the grounds that his intent was not tax-motivated and disallowing the partnership investment on the grounds his motivation did not control but that of the person who sold it to him. In the field of tax shelters, imputing the intent of the promoter-general partner to the taxpayer limited partner makes no more sense than attributing to Little Red Riding Hood the intent of the wolf.

However, even more importantly in this, as in so many other matters, the Tax Court has anticipated the Congress. Partnerships were not treated as tax entities until the enactment of Section, *et. seq*, "Tax Treatment of Partnership Items." This particular partnership item to be determined at the partnership level was not enacted into regulation until April 15, 1986 by regulation 301.623 (a) (3) -1. Section 4231 of the Code provides that partnership items to be determined at the partnership level are to be enacted by regulation. This enactment was not made until years after the Tax Court assumed authority.

4. The Tax Court's Findings With Respect To Economic Reality And Motivation Should Have Been Reviewed As Questions Of Law Rather Than Fact

All branches of government treat taxpayers in general as if they had the attributes of the holiest of saints. The Courts, Congress and the Executive branch seem to outdo each other in their attribution of virtue. However, an individual taxpayer, on the other hand, is treated in litigation worse than the most deep-dyed criminal and prevaricator. The field which we are dealing with is concerned with the question of whether a taxpayer is motivated by economic considerations or *solely* motivated by tax avoidance considerations. Some courts have gone so far with respect to this

question as to say the taxpayer's statements of intent are to be given "little weight". *Nickerson v. Commissioner*, 700 F.2d 402, at 404. Realizing that any party to litigation may have a tendency to make self-serving statements, we feel it is unfair to single out the poor taxpayer. If the Commissioner has proof that there was tax motivation, this is one thing but a taxpayer may not in all cases conclusively be presumed to lie.

The real vice of the Commissioner's reliance on Section 183 has to do with the opinion of some Courts of Appeal, of which *Nickerson* is one, that the question of economic reality and whether there was a real transaction or a sham entered into only for tax avoidance reasons is a question of fact. This case, *Nickerson, Faulconer v. Commissioner*, 748 F.2d 890 (1984) and many other cases under Section 183 treat the question as one of fact requiring that an appellant prove that the Tax Court' s decision was "clearly erroneous." Since it is a widely held conception that a taxpayer's testimony is not only not to be trusted but in most cases, must be rejected, the taxpayer faces an almost insurmountable burden, particularly as here where he must prove a negative, that he had an honest intent to earn a profit.

In *Frank Lyon*, this Court recognized that the fact that a taxpayer may be a good enough business man to realize that tax considerations are economically important without creating a sham transaction which is not recognized for tax purposes. The Court says, which it has said on many occasions, "we cannot ignore the reality that the tax laws affect the shape of really every business transaction." The *Frank Lyon*, in footnote 16, cited with approval, *American Realty Trust v. U.S.* 498 F.2d 1194, at p. 1198. There the Court held in a case similar to us: "The general characterization of a transaction for tax purposes is a question of law subject to review." In *Commissioner v. Groetzinger* 107 S.Ct. 980 (1987) at p. 987,the issue was whether or not the taxpayer was engaged in a trade or business. The Court held "that resolution of this issue requires an examination of the facts in each case. " The Court conceded that this might be "thought by some to be a less than satisfactory solution" . . . "But the difficulty rests in the Code' s wide utilization in various contexts of the term "trade or business" in the absence of an all-purpose definition by

statute or regulation, and in our concern that an attempt judicially to formulate and impose a test for all situations would be counterproductive, unhelpful, and even somewhat precarious for the overall integrity of the Code."

The *Groetzinger* case involved the case of whether a gambler was engaged in a trade or business. The *Lyon* case involved a business which was used in part for the purpose of tax avoidance. In both cases, the Courts cautioned the Court of Appeals to examine the facts to determine the legal question of whether there was a business or solely tax or hobby motivation. This case is one of stipulated facts. The Court of Appeals is really in just as good a position to judge the matter as the Tax Court. The Tax Court made no finding that the taxpayer was a liar. In fact, generally, it found favorably to both him and the investment.

We can find no cases where the Courts of Appeal followed *Groetzinger*. In respect to whether the question involved here is law or fact, Groetzinger has simply been ignored. If the Court really meant what it said in both *Groetzinger* and *Frank Lyon*, and if it believes that *American Realty Trust v. U.S., supra*, is a proper view, certiorari should be granted in this case.

CONCLUSION

The use of Section 183 in regulating what it believes to be undesirable business losses and to some extent what it considers to be undesirable businesses or literary works presents considerable advantages to the Commissioner. He does not have to prove the sham required by *Frank Lyon* and he can use the threat of forfeiture of a taxpayer's cash invested as a bargaining device to avoid litigation. *Rice's Toyota World* is in direct conflict with this case. There, the Tax Court was required to credit the taxpayer for his cash equivalent.

The Court at the very least should reconcile the approach of *Frank Lyon* and the Tax Court's regulation of tax motivated deductions. Similarly, by realizing the danger of amplifying the Commissioner's presumption of correctness by review limited to "clearly erroneous" cases it should conform review of whether certain deductions are really legitimately business to the stan-

dards of *Groetzinger* and *Lyon*. This is true whether the tax issue is hobby versus business, or abusive tax shelter versus legitimate business. Further, the Court should clarify whether the two-part test of *Frank Lyon* requires both a solely taxed motivation and economic reality, or only one of the two. See *Shriver v. Comm.*, supra.

We submit that this case in view of the findings of the Tax Court that this transaction was "bona fide" makes it an admirable vehicle for review of this important subject.

DATED: October 17, 1991

Respectfully submitted,

RICHARD H. FOSTER
Richard H. Foster
Attorney for Petitioner

Appendix A

Not for Publication

United States Court of Appeals
For The Ninth Circuit

Harris Cashman,
Petitioner-Appellant,

v.

Commissioner Internal Revenue Service,
Respondent-Appellee.

No. 89-70532
Tax Ct. No. 12372-85

MEMORANDUM*

[Filed Apr 3 1991]

Appeal from a Decision of the
United States Tax Court

Submitted March 14, 1991**
Palo Alto, California

Before: D.W. NELSON, KOZINSKI and T.G. NELSON, Circuit Judges.

In order to deduct expenses of an activity under section 162 or 212 of the Internal Revenue Code, appellant was required to show that he engaged in the activity with an actual and honest objective of making a profit. *See* 26 U.S.C. §§ 162 & 212; *Beck v. Commissioner*, 85 T.C. 557, 568 (1985). After weighing the evidence, the Tax Court concluded that "petitioner has failed to carry his burden of proof to show that he purchased 'The Year of December' with an actual and honest objective of making a profit." E.R. 4, at 10. This finding is not clearly erroneous.

---

* This disposition is not appropriate for publication and may not be cited to or by the courts of this circuit except as provided by 9th Cir. R. 36-3.

** The panel unanimously finds this case suitable for decision without oral argument. Fed. R. App. P. 34(a); 9th Cir. R. 34-4.

Equally meritless is appellant's claim that the Tax Court erred by applying section 183 to an activity not conducted as a personal hobby. The legislative history cited by appellant cannot overcome the plain language of section 183, which disallows a deduction for any activity "not engaged in for profit." 26 U.S.C. § 183(a); *see* 26 U.S.C. § 183(c) ("For purposes of this section, the term 'activity not engaged in for profit' means *any activity* other than one with respect to which deductions are allowable . . . under section 162 or . . . section 212." (emphasis added)); *see, e.g., Beck* 85 T.C. 557 (purchase of publishing rights for tax purposes not activity engaged in for profit); *Dean v. Commissioner*, 83 T.C. 56 (1984) (same); *Sutton v. Commissioner*, 84 T.C. 210 (1985) (ownership of refrigerated highway freight cars not activity engaged in for profit), *aff'd* 788 F.2d 695 (11th Cir. 1986).

Appellant also misconstrues section 183(d) when he argues that receiving some income from the publishing venture establishes a presumption of a profit objective. Rather, section 183(d) creates a presumption that an activity is engaged in for profit where, during a specified period, gross income "exceeds the deductions attributable to such activity." 26 U.S.C. § 183(d). Appellant has not produced any evidence that the proceeds he received from the venture during 1982, 1983 or 1985 constituted income exceeding expenses attributable to the publishing activity.

Appellant's argument that denying him any deduction under section 183 causes him to forfeit his out of pocket expenses fails under similar reasoning. Section 183(b)(2) allows a deduction *only* to the extent that appellant's gross income derived from the venture exceeds expenses attributable to that venture, regardless of whether the activity was engaged in for profit. 26 U.S.C. § 183(b)(2).

AFFIRMED.

Appendix B

T. C. Memo 1989-533

United States Tax Court

Harris Cashman,
Petitioner,

v.

Commissioner of Internal Revenue,
Respondent.

Docket No. 12372-85. Filed September 27, 1989.

Richard H. Foster, for the petitioner.
Andrew M. Winkler, for the respondent.

MEMORANDUM FINDINGS OF FACT AND OPINION

GOFFE, *Judge*: This case was assigned to and heard by Special Trial Judge Joan Seitz Pate pursuant to section 7456(d) [redesignated as section 7443A(b) by the Tax Reform Act of 1986, Pub. L. 99-514, sec. 1556, 100 Stat. 2755], and Rules 180, 181, and 183.[1] The Court agrees with and adopts the Special Trial Judge's opinion which is set forth below.

OPINION OF THE SPECIAL TRIAL JUDGE

PATE, *Special Trial Judge*: The Commissioner determined deficiencies in petitioner's Federal income tax of $49,667 for the taxable year 1978 and $58,796 for the taxable year 1979. These deficiencies result from the disallowance of claimed losses and investment credits arising from petitioner's investment in a book entitled "The Year of December" in 1978 and 1979 and his participation in The Dover Collection (hereinafter "Dover"), a limited partnership involved in the book publishing industry, in 1979. The Commissioner also determined that petitioner is liable under section 6621 for increased interest on the deficiencies for both years.

---

[1] All section references are to the Internal Revenue Code, as amended and in effect for the years in issue. All rule references are to the Tax Court Rules of Practice and Procedure.

The issues for our decision are:

(1) whether petitioner sustained deductible losses and allowable investment credits as a result of his publishing activities in 1978 and 1979;

(2) whether petitioner's participation in these activities constituted tax-motivated transactions, subjecting the deficiencies resulting therefrom to an increased rate of interest under section 6621(c) (formerly section 6621(d)); and

(3) whether petitioner has maintained this suit primarily for purposes of delay and, is therefore liable for damages pursuant to section 6673.

This case involves petitioner's participation in two transactions with Jonathan T. Bromwell & Associates, Inc. (hereinafter "Bromwell"), an entity which acquired and marketed mass-market paperback books. This Court has considered similar transactions promoted by Bromwell. Petitioner's acquisition of "The Year of December" follows the pattern of the transactions involved in *Elliott v. Commissioner*, 84 T.C. 227 (1985), affd. without published opinion 782 F.2d 1027 (3d Cir. 1986), and *Ziegler v. Commissioner*, T.C. Memo. 1984-620. Petitioner's investment as a limited partner in Dover is, in all material aspects, the same as the limited partnership interest we considered in *Leger v. Commissioner*, T.C. Memo. 1987-146, affd. without published opinion 860 F.2d 435 (5th Cir. 1988). The parties stipulated most of the record in *Leger v. Commissioner, supra*, into evidence in this case. Hereinafter, we refer to petitioner's interest in both "The Year of December" and Dover as the "Bromwell offerings" or the "Bromwell transactions."

Petitioner, aware of our prior opinions in *Elliott, Ziegler*, and *Leger*, does not contest our decisions in those cases; rather, he seeks to distinguish his Bromwell transactions by maintaining that his losses are deductible and investment credits allowable because:

(1) petitioner had a bona fide objective of profit;

(2) petitioner's investment in 1978 in "The Year of December" is not subject to the at-risk rules;

(3) petitioner's investment in "The Year of December" was bona fide;

(4) the appraisals prepared by respondent's experts in this case were not based on fact;

(5) section 183 does not apply because petitioner made a profit on "The Year of December"; and

(6) petitioner suffered a theft loss in 1979 to the extent of his investment in Dover.

Because the transactions into which petitioner entered have been fully described in *Elliott, Ziegler*, and *Leger*, we include here only a summary of those facts which are peculiar to this case.

FINDINGS OF FACT

Some of the facts have been stipulated and are so found. We incorporate herein the stipulation of facts and exhibits attached thereto by this reference. Petitioner resided in Las Vegas, Nevada, at the time he filed his petition.

Harris Cashman (hereinafter "petitioner") is single. He filed him Federal income tax returns for 1978 and 1979 with the Internal Revenue Service in Ogden, Utah. During the years at issue, he was an executive with Cashman Photo Enterprises, Inc. (hereinafter "Cashman Photo"), receiving a substantial (six figure) annual income therefrom. The company operated photography concessions in hotels and casinos in Las Vegas, Nevada, and Atlantic City, New Jersey. Cashman Photo engaged camera girls, who circulated among customers of the hotels, taking pictures, then selling the photos to the photographed customers.

Petitioner started Cashman Photo in 1967 and was joined by his brother, Morgan Cashman (hereinafter "Morgan"), approximately 2 years later. Each brother owns 50 percent of the capital stock. Cashman Photo started operations in Las Vegas and expanded to Atlantic City when gambling was introduced there.

Both petitioner and Morgan have high school educations. Neither has had formal training in photography; they learned the trade from their stepfather. Petitioner's duties have centered

around the photography end of the business. Morgan is the President of Cashman Photo and has handled most of the financial matters.

In addition to their ownership of Cashman photo, petitioner and Morgan have made other investments over the years. They own a number of pieces of real estate, and owned and operated a gaming school at which instructors trained students to be dealers in gambling casinos.

Morgan hired George Swarts (hereinafter "Swarts") to perform accounting services for Cashman Photo. Swarts also provided accounting and tax services to both brothers individually, and acted as their business and tax advisor. Over the years, Swarts became Morgan's friend.

Swarts brought the Bromwell offerings to Morgan's attention. Although Swarts had no expertise in the publishing industry, he portrayed the Bromwell offerings as good investments.

Neither petitioner nor Morgan read the offering memorandum or any other document evidencing their participation in the Bromwell transactions. Petitioner purchased his interests in the Bromwell transactions on the basis of short phone calls from Morgan, who urged him to make the investments explaining that they were "good deals." Neither petitioner nor Morgan made any serious attempt to investigate the profitability of the proposed transactions.

In 1978, petitioner paid $45,000 in cash and assumed a nonrecourse promissory note of $190,000 to acquire all of the rights, title, and interest in "The Year of December" from Bromwell. As stated earlier, this transaction was structured, in all material respects, in the same manner as the transactions described in *Elliott* and *Ziegler*. We incorporate the relevant facts in those cases by this reference.

In 1979, petitioner purchased two-thirds of one limited partnership unit in Dover for $30,000 in cash. Dover was a limited partnership organized on December 26, 1979, by Madison Library, Inc. (hereinafter "Madison"). Dover had 35 limited partners who paid $45,000 cash per unit for their partnership interest.

In the aggregate, Dover collected $1,147,500 cash in exchange for 25.5 units. Subsequently, Dover acquired 47 books from Bromwell for a total purchase price of $12,236,000, paying $828,000 in cash and $11,408,000 in nonrecourse promissory notes. Shortly before Dover's purchase, Bromwell purchased the books for $11,623,000, $215,000 in cash and $11,408,000 in nonrecourse notes. This transaction was structured, in all material respects, in the same manner as the transaction described in *Leger*. We incorporate the relevant facts in that case by this reference.

OPINION

Because petitioner's purchase in 1978 of "The Year of December" was, in all material respects, identical to the transaction described in *Ziegler*, we turn first to our decision in that case. There we decided that the taxpayer had not engaged in the book publishing activity for profit, and therefore, no deduction in excess of the gross income realized therefrom would be allowed. Sec. 183(a). We also held that no investment credit was allowable under section 38(a) and that the taxpayer was liable for an addition to tax for negligence or intentional disregard of the rules and regulations under section 6653(a). Petitioner has failed to distinguish his transaction from that in *Ziegler*, and therefore, the reasoning and holding in that case applies equally to his transaction involving "The Year of December."

In 1979, petitioner purchased two-thirds of one unit in the Dover partnership. The Dover transaction is essentially the same as the partnership transaction described in *Leger*. In *Leger*, we held that the partnership failed to show that it engaged in its activities with an actual and honest objective of making a profit, and therefore, that no deduction in excess of the gross income realized therefrom would be allowed. Sec. 183(a). We also held that the increased rate of interest under section 6621(c) (formerly section 6621(d)) was applicable on that portion of the deficiency attributable to the investment in the partnership.

With regard to the Dover collection, petitioner concedes that, based upon the criteria set down in *Leger*, his transaction was not

an activity engaged in for profit under section 183. Therefore, we apply our reasoning and holding *Leger* to petitioner's interest in the Dover collection. Having found that petitioner has failed to distinguish his case from *Ziegler* and *Leger*, we now turn to address petitioner's "new" arguments with regard to his Bromwell transactions.

Bona Fide Objective of Profit

Petitioner first contends that he had a bona fide objective of realizing a profit when he entered into the Bromwell transactions. He maintains that he routinely relied upon his brother to recommend good investments, that his brother recommended these investments as "good deals," and then based upon this recommendation, he purchased "The Year of December" and his interest in Dover.

Under section 183(a), if an individual's activity is "not engaged in for profit," no deduction attributable to such activity is allowed except to the extent of the income derived from such activity as provided in section 183(b). The test under section 183 is whether the individual engaged in the activity with an actual and honest objective of making a profit. *Dreicer v. Commissioner*, 78 T.C. 642, 645 (1982), affd. without opinion 702 F.2d 1205 (D.C. Cir. 1983). In this context, "profit" means an economic profit independent of tax savings. *Estate of Baron v. Commissioner*, 83 T.C. 542, 557-559 (1984), affd. 798 F.2d 65 (2d Cir. 1986); *Hirsch v. Commissioner*, 315 F.2d 731, 736 (9th Cir. 1963), affg. a Memorandum Opinion of this Court. While a reasonable expectation of profit is not necessary, petitioner's profit objective must be bona fide. *Bessenyey v. Commissioner*, 45 T.C. 261, 274 (1965), affd. 379 F.2d 252 (2d Cir. 1967), cert. denied 389 U.S. 931 (1967). In making this determination, objective facts are given greater weight than the parties' statements of their intent. *Thomas v. Commissioner*, 84 T.C. 1244, 1269 (1985), affd. 792 F.2d 1256 (4th Cir. 1986).

The regulations contain a nonexclusive list of factors to consider in determining whether an activity is engaged in for profit. Briefly, these factors include the following: (1) the manner in which the taxpayer carried on the activity; (2) the expertise of the

taxpayer and his advisors; (3) the time and effort expended by the taxpayer in carrying on the activity; (4) the expectation that assets used in the activity may appreciate in value; (5) the success of the taxpayer in carrying on similar or dissimilar activities; (6) the taxpayer's history of income or loss with respect to the activity; (7) the amount of occasional profit, if any, which is earned; (8) the financial status of the taxpayer; and (9) whether elements of personal pleasure or recreation are involved. Sec. 1.183-2(b), Income Tax Regs. No one factor is controlling, but it is an evaluation of all of the facts and circumstances in the case, taken as a whole, which is determinative. Sec. 1.183-2(b), Income Tax Regs.; *Abramson v. Commissioner*, 86 T.C. 360, 371 (1986).

In reviewing these factors as they relate to petitioner, it is absolutely clear that petitioner has failed to carry his burden of proof to show that he purchased "The Year of December" with an actual and honest objective of making a profit. With regard to factors (1) and (3) (the time and manner in which the taxpayer carried on the activity), we note that the amount and quality of his participation was minimal. The total time exploring whether "The Year of December" was a "good deal" comprised one short telephone call. Moreover, there is no evidence to show that Swarts investigated the merits of the Bromwell offerings, either on behalf of Morgan or petitioner. This is by far not an adequate investigation of a proposed investment involving the expenditure of $45,000 in cash and an indebtedness of $190,000. Afterward, except for sending his check to Bromwell, petitioner seems to have had no further interest in the activity. In short, he did not devote any meaningful time to this activity.

With regard to factor (2) (the expertise of the taxpayer), petitioner admitted at trial that he had no experience in the book publishing industry and did nothing to seek out such expertise in evaluating his investment. With regard to factor (4) (the expectation that the assets used in the activity may appreciate in value), we find that by amortizing the entire purchase price over a 9-year period petitioner has represented that the book would be worthless at the end of that time period. Further, there is ample evidence in *Leger* that the useful life of mass market paperback

books was considerably less than 9 years. With regard to factor (5) (the success of the activity in carrying on any similar or dissimilar activity), there is no evidence that petitioner ever carried on any type of activity similar to this one, either before or after the years in issue. With regard to factor (6) (the taxpayer's history of income or loss with respect to the activity), we find no evidence of anything but losses. The 7th factor requires us to consider the extent of occasional profits. In this case, there were no profits. The 8th factor focuses upon the financial status of the taxpayer. Although we have no definitive estimate of petitioner's net worth, we do know that he earned a substantial income. In addition, he owned real estate and 50 percent of Cashman Photo. Consequently, it appears that petitioner sought to take advantage of the promised tax benefits offered by Bromwell. With regard to the 9th factor (whether the elements of personal pleasure or recreation were involved), there is no evidence that petitioner read the books he purchased or was interested in purchasing books for their literary content. Therefore, this factor is relatively neutral. However, all of these other facts point to the conclusion that petitioner did not have the requisite profit objective.

With regard to Dover, petitioner argues that we should focus on his profit objective rather than that of the general partners as we did in *Leger*. However, it is well established that, where a partnership is involved, the issue of whether an activity is one engaged in for profit is determined at the partnership level. In making such a determination, we focus on the objective of the general partner since he is the individual who actually controls the partnership's activities. *Fuchs v. Commissioner*, 83 T.C. 79, 98 (1984); *Brannen v. Commissioner*, 78 T.C. 471, 505 (1982), affd. 722 F.2d 695 (11th Cir. 1984). We have evaluated the general partner's objective in *Leger*, and the record in that case was stipulated into this one. Moreover, no additional evidence of the general partner's intent was submitted in this case. Consequently, our analysis remains unchanged. For these reasons, we find that petitioner did not possess the requisite profit objective with regard to either "The Year of December" or Dover.

At Risk Rules

Petitioner next argues that since he made his investment in "The Year of December" in 1978, the at-risk rules set forth in section 465 do not apply to him, as the amendment to those rules, which included book publishing activities, did not take effect until 1979. Petitioner's argument is misplaced.

Section 465 was enacted as part of the 1976 Tax Reform Act and applies, generally, to losses attributable to amounts paid or incurred in taxable years beginning after December 31, 1975. It was considerably broadened in 1978, effective generally to taxable years beginning after December 31, 1978. Sec. 201, Revenue Act of 1978, Pub. L. 95-600, 92 Stat. 2814. For taxable years beginning before 1979 the at-risk rules applied only to certain specified activities to the extent the taxpayer was engaged in the activities as a trade or business or for the production of income. Sec. 465(c)(1). In other words, section 465 does not even come into play unless the activity at issue is one that constitutes either a trade or business or is one that is entered into for the production of income.

We made our decision in *Ziegler* under section 183(a). As we stated earlier, petitioner failed to show any distinction between his activities with regard to "The Year of December" and those in *Ziegler*. Consequently, we have concluded that his activity regarding "The Year of December" was an activity not entered into for profit. Lacking a profit objective, the activity could not constitute either a trade or business or an activity entered into for profit. Therefore, section 465 simply does not have any application to our determination in this case.

Bona Fide Investment

Next, petitioner contends that "The Year of December" was a bona fide investment (not a sham), and, therefore, his losses and investment credit should be allowed. He argues in support thereof that the publisher (Kensington/Hercules) is one of the strongest of the independent publishing houses, that Kable News Co., the distributor, had been in existence for years prior to the years in issue and had distributed other books which wound up on best

seller lists, and consequently, that the activities at issue were bona fide.

We have no quarrel with his argument that the publishing and distribution of the books was a bona fide activity. In fact, in *Leger*, we considered that argument as it related to the limited partnership "Arts":

> Nevertheless, petitioner argues that because its publishers and distributors entered into these activities with a profit objective, Arts necessarily had a profit motive. We do not doubt that Gallen and Kensington entered into their agreements with Arts intending to make reasonable sales efforts on behalf of the 23 titles resulting in a profit for them. In fact the agreements were so structured. However, the publishers were adverse parties to Arts. To maximize their profit, Gallen and Kensington negotiated for as much of the proceeds as they could get, and to the extent they were successful, the proceeds to Arts were reduced accordingly. Therefore, there is no justifiable reason why we should attribute their motives to Arts. [Footnote refs. omitted; 53 T.C.M. 377, 395, 56 P-H Memo T.C. par. 87,146 at 87-723.]

This reasoning applies equally to this case. Taking into account that the transaction was bona fide, that the books were published and distributed, and that the publisher/distributor were recognized, established companies in their trade, does not change our determination that petitioner did not have the requisite objective for profit under section 183. As in *Leger*, we look not to the economic consequences attendant to publishers and distributors, but to the profit potential accruing to petitioner as a purchaser of "The Year of December" and as a limited partner in Dover. The extraordinary purchase price paid by petitioner and Dover coupled with the large amounts of nonrecourse promissory notes involved lead us back to the conclusion that no profit objective existed. Therefore, even though the transaction was bona fide, that fact does not alter our decision with regard to the deductibility of the losses and the allowance of the investment tax credits.

Respondent's Experts

Next, petitioner complains that respondent's experts' appraisals were not based on fact, and therefore, their opinions should be given little weight. Part of petitioner's brief is directed toward the argument that respondent's experts did not have the operative documents in front of them upon which to make the appraisals. However, petitioner misapprehends the object of those expert reports. In those reports, the experts attempted to determine the value of the manuscripts which were used to produce the books. They did not attempt to evaluate the transaction Bromwell formulated.

Moreover, petitioner misapprehends the nature of this proceeding. In this Court, it is petitioner who has the burden of proof and must show the Court that he is entitled to the claimed losses and investment credits. Petitioner produced no evidence that the books involved were priced at their fair market value or that the arrangement under which they were sold might have been profitable. Such proof, if it had been submitted, would have buttressed petitioner's testimony. We look to objective facts to find petitioner's true objective. *Thomas v. Commissioner*, 84 T.C. at 1269.

Realized Profits

Petitioner further alleges that he realized a profit during 1982, 1983, and 1985 on "The Year of December" and that fact should show conclusively that the activity was engaged in for profit. However, we find no evidence in the record to support the contention that petitioner made a profit from his book publishing activities in any year. If a profit had been made, evidence could have easily been submitted to show that petitioner reported such profits on income tax returns submitted in later years. No such evidence was propounded. On the contrary, petitioner testified that he did not deduct losses he sustained subsequent to 1979. We fail to see how petitioner's brief can even raise this argument.

Theft Loss

Finally, petitioner contends that he was a victim of theft with regard to the Dover transaction, characterizing that Bromwell

operation as "close to being a scam." He argues, therefore, that he should be entitled to a theft loss for the amount of his investment, citing *Nichols v. Commissioner*, 43 T.C. 842 (1965), in support thereof.

Section 165 generally allows a taxpayer to deduct losses arising from theft of property. Sec. 165(a) and (c)(3). We defined "theft" in *Nichols v. Commissioner*, 43 T.C. at 884, as follows:

> Theft, as used in section 165 of the Internal Revenue Code of 1954, is "a word of general and broad connotation, intended to cover and covering any criminal appropriation of another's property to the use of the taker, particularly including theft by swindling, false pretenses, and any other form of guile * * *."

There is absolutely no evidence in this record to show that there was any theft, swindle, or misrepresentation on the part of Bromwell or that petitioner gave his money to Bromwell involuntarily. Petitioner got what he intended to buy. See *Viehweg v. Commissioner*, 90 T.C. 1248, 1254-1255 (1988). Moreover, losses arising from theft are treated as sustained Sec. 165(e); *Marine v. Commissioner*, 92 T.C. 958, 976 (1989); *West v. Commissioner*, 88 T.C. 152, 162 (1988). Petitioner testified that during 1978 and 1979 he was looking forward to making a profit from these transactions. Even assuming a "theft" had occurred, by his own testimony he reveals that he had no knowledge of it during the years at issue. Accordingly, the losses claimed by petitioner during 1978 and 1979 cannot be deducted under section 165.

Section 6621(c)

The Commissioner determined that petitioner is liable under section 6621(c) (formerly section 6621(d)) for interest on the underpayments for 1978 and 1979 at 120 percent of the statutory rate. That section provides for an increase in the rate of interest payable under section 6601 with respect to a "substantial underpayment" (an underpayment of more than $1,000) attributable to a "tax motivated transaction."

Certain transactions are deemed to be "tax motivated" by section 6621(c)(3). In addition, the Secretary of the Treasury is given authority to promulgate regulations specifying additional transactions that are to be deemed tax motivated. Sec. 6621(c)(3)(B). Under the regulations, deductions disallowed under section 183 because an activity was not engaged in for profit are attributable to a tax-motivated transaction. Sec. 301.6621-2T, Q-4 & A-4, Temp. Proced. & Admin. Regs., 49 Fed. Reg. 50394 (Dec. 28, 1984).

Here, we have found that petitioner engaged in his book publishing activities without a profit objective under section 183. Therefore, it follows that his activities were tax-motivated transactions. Accordingly, we hold that petitioner is liable for additional interest on his 1978 and 1979 tax deficiency attributable to the disallowance of the deductions petitioner claimed arising from the Bromwell transactions. Cf. *Patin v. Commissioner,* 88 T.C. 1086, 1129 (1987), affd. without published opinion 865 F.2d 1264 (5th Cir. 1989), affd. without published opinion sub nom. *Hatheway v. Commissioner,* 856 F.2d 186 (4th Cir. 1988), affd. sub nom. *Skeen v. Commissioner,* 864 F.2d 93 (9th Cir. 1989), affd. sub nom. *Gomberg v. Commissioner,* 868 F.2d 865 (6th Cir. 1989).

Next, we consider whether section 6621(c) applies to that portion of the deficiency attributable to the investment credit disallowed by respondent. In this regard, section 6621(c)(3)(A)(i) includes as a tax motivated transaction "any valuation overstatement (within the meaning of section 6659(c))[.]" Under section 6659(c)—

> there is a valuation overstatement if the value of any property, or the adjusted basis of any property, claimed on any return is 150 percent or more of the amount determined to be the correct amount of such valuation or adjusted basis (as the case may be).

On petitioner's 1978 income tax return he claimed that "The Year of December" had a basis of $227,000, which was reduced by a $52,000 depreciation deduction to $175,000 by the end of the year. On his 1979 income tax return, he further reduced this basis

(by claiming $45,000 in depreciation) to $130,000. In addition, for 1979, Dover claimed a basis in its books of $12,236,000 and an adjusted basis at the end of the year of $10,876,444.

It is generally accepted that where property is acquired by purchase, its cost includes the amount of liabilities assumed, or taken subject to, by the purchaser. *Crane v. Commissioner,* 331 U.S. 1 (1947); *Parker v. Delaney,* 186 F.2d 455 (1st Cir. 1950); *Blackstone Theatre Co. v. Commissioner,* 12 T.C. 801, 804 (1949). That the liability is secured only by the asset transferred and the purchaser otherwise has no personal liability will not, in and of itself, prevent such liability from being included in the basis of the property. *Mayerson v. Commissioner,* 47 T.C. 340 (1966). However, it is well settled that basis is determined by the actual investment in the property. *Siegel v. Commissioner,* 78 T.C. 659, 684 (1982); *Narver v. Commissioner,* 75 T.C. 53, 98 (1980), affd. per curiam 670 F.2d 885 (9th Cir. 1982). Therefore, where nonrecourse indebtedness unreasonably exceeds the fair market value of the acquired property, then no genuine indebtedness exists and there is no "investment in the property" attributable to such indebtedness and the indebtedness is not added to basis. *Fuchs v. Commissioner,* 83 T.C. 79, 101-102 (1984).

Petitioner did not establish the fair market value of the books in this case. Moreover, respondent's experts convinced us that the fair market value of the books was so low that petitioner and Dover had no "investment in the property" to the extent of the nonrecourse indebtedness attributable thereto. Consequently, the adjusted basis of the books shown on petitioner's 1978 and 1979 income tax returns and Dover's 1979 partnership return far exceed 150 percent of the correct amount of adjusted basis. *West v. Commissioner,* 88 T.C. 152, 164-165 (1987). Accordingly, petitioner is liable for the increased rate of interest provided for in section 6621(c) on the entire deficiencies (resulting from both claimed losses and investment credits) as they constitute substantial underpayments of tax attributable to tax motivated transactions.

Damages

Finally, on our own motion, we consider whether we should award damages under section 6673. Damages under that section are awarded to the United States when it appears that an action was instituted or maintained primarily for delay, that the taxpayer's position in such proceedings is frivolous or groundless, or that the taxpayer unreasonably failed to pursue available administrative remedies. Although petitioner has not prevailed on any of his arguments in his attempt to distinguish his case from *Ziegler* and *Leger*, we refrain from awarding damages in this case. However, we have decided cases involving Bromwell transactions several times, this time being at least the fourth such case. Therefore, taxpayers are cautioned against unnecessarily tying up this Court again; at least, not without risking untoward effects should we determine such action was frivolous or was instituted or maintained primarily for delay.

Decision will be entered
for the respondent.

APPENDIX C

United States Court of Appeals

For The Ninth Circuit

No. 89-70532
Tax Ct. No. 12372-85

HARRIS CASHMAN,
Petitioner-appellant,

vs.

COMMISSIONER INTERNAL REVENUE SERVICE,
Respondent-appellee.

ORDER

Before: D.W. NELSON, KOZINSKI and T.G. NELSON, Circuit Judges.

The petition for rehearing is denied. The full court has been advised of the suggestion for rehearing en banc and no judge has requested a vote thereon. The suggestion for rehearing en banc is therefore denied. Fed. R. App. P. 35(b).